



UNIVERSITI PUTRA MALAYSIA

**REVALUATION EFFECT OF AUDITOR SWITCH IN MALAYSIA AND
ITS DETERMINANTS**

HUSON JOHER ALIAHMED

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DETERMINANTS**

By

HUSON JOHER ALIAHMED

**Thesis Submitted in Fulfillment of the Requirements for the Degree of Doctor of
Philosophy in the Malaysian Graduate School of Management,
Universiti Putra Malaysia**

May 2000



DEDICATION

***DEDICATED TO MY PARENTS, BROTHERS AND SISTERS AND FELLOW
COLLEAGUES***

Abstract of thesis presented to the Senate of the Universiti Putra Malaysia in fulfilment of the requirements for the degree of Doctor of Philosophy.

REVALUATION EFFECT OF AUDITOR CHANGE IN MALAYSIA AND ITS DETERMINANTS

By

HUSON JOHER ALIAHMED

May 2000

Chairman : Mohamad Ali Abdul Hamid, Ph.D.

Faculty : Faculty of Economics and Management

A body of accounting literature has grown on the phenomena of auditor switches mostly in developed countries from the research by academics, accounting professionals and industry experts because of its strategic implication for a firm value, credibility of financial reporting and the cost of monitoring management activities. Despite the growing concerns shown in the developed economies about the consequence of auditor switches, which are associated with substantial direct and indirect costs, little attempt appears to have been made in Malaysia to examine the possible reasons for changing auditors or to estimate the shareholders wealth implication. Thus, the objective of this study is to make a start in examining this very significant accounting activity in a fast developing Malaysian economy, perhaps, to serve as an example of more studies in emerging countries. The particular objectives are (a) to ascertain determinants of auditor switch in Malaysia, (b) to examine the hypothesised relationship between the changes in firms' characteristics and choice of quality differentiated audit firms and (c) to ascertain the share valuation effect of

auditor switches in Malaysia. Audit firms are clearly ranked as belong to a higher and lower prestige category in this country, which enables, it is hoped, a search for the revaluation effect.

Many researchers examined the determinants of auditor switches and its effect on share valuation. Some of these research efforts resulted in findings that were inconsistent with each other. The current research was therefore undertaken with the objectives of developing both theoretical framework and empirical model and to explain the justification for considering certain specific factors that may be important for corporate management decision to switch auditor and its effect on share valuation. Four extant theories of accounting and auditing (agency theory, theory of auditor change and choice, signalling theory and partially revealing rational expectation theory) were reviewed and used in developing the theoretical framework for this research.

An empirical experiment was designed to test firms related factors hypothesised to be the determinants of auditor switches. A sample of 108 client firms was isolated as having switched auditors at least once during the period 1986 to 1996. A logistic regression method was adopted to ascertain both determinants of auditor switches and choice of quality differentiated auditor connected to changes in a number of firms' characteristics. The standard event study method widely applied in this field is used to examine the share valuation effect of auditor switches.

From the logistic regression, the variables, management change, turnover growth both prior and after auditor switches and firm's performance measured by return on asset were found to be significant determinants of auditor switch in Malaysia. However, other variables like auditor report and audit fees were not found

to have any significant effect on the auditor switch in Malaysia. The factors attempting to explain the choice of higher prestige (Tier1) audit firms, this study provides evidence that asset size, changes in operating cash flow to total asset and firms acquisition of fixed asset to total asset as the important determinants of choice of higher prestige audit firms in Malaysia. While choice of lower prestige (Tier2) audit firms are determined by decrease in size, lower firms leverage preceding the switch and acquisition of fixed asset to total asset.

Using standard event study method, this study provides evidence of weak positive market reaction for auditor switch in Malaysia. However, once the revaluation effect of auditor switch was tested based on auditor switch type and firms' observable characteristics, different results emerged. The market appears to respond positively to client firms that had switched to higher prestige audit firms. Cumulative abnormal return (CAR) prior to the announcement over the period (-60 to -0) and (-8 to -1) recorded a net gain of 7.85% and 2.24% respectively, significant at 10% and better. This reflects a good news to the investors. In contrast the revaluation effect of client firms switching to less prestige audit firms recorded a marginally significant negative cumulative abnormal returns. The CAR over the days (-8 to -1) exhibited cumulative loss of 4.56%, reflecting an incremental reduction in shareholders wealth. Moreover, revaluation effect of auditor switches within the classes reported in a weak negative market reaction. And no contemporaneous price changes were observed surrounding the auditor changes. The revaluation effects of auditor switches made by both financially healthy and unhealthy firms were also analysed. The results suggested a weak positive market reaction to auditor switches made by financially healthy firms compare to those of unhealthy firms, which

registered marginally significant negative reaction. Moreover, switches made by client firms, which received clean opinion prior to auditor switch, reported a weak positive market reaction. Though significant abnormal return relative to auditor change were observed, none of the auditor change type reported any significant abnormal return on the day of announcement itself. This is probably due to information leakage and auditor change as predictable consequence of firms activities, which are more common in developing market like Malaysia.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Doktor Falsafah

**KESAN PENILAIAN SEMULA PENUKARAN JURUAUDIT DI MALAYSIA
DAN FAKTOR-FAKTOR PENENTUNYA**

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Lantaran penyelidikan yang dijalankan oleh ahli akademik, ahli profesional perakaunan dan pakar-pakar industri yang berkaitan, suatu himpunan penulisan perakaunan yang membicarakan fenomena pertukaran juruaudit di kebanyakan negara membangun telah dihasilkan. Ini kerana penukaran juruaudit membawa implikasi strategik terhadap nilai sesebuah firma, kredibiliti laporan kewangannya dan kos pemantauan aktiviti-aktiviti pengurusan. Walaupun kebimbangan negara-negara maju terhadap kesan-kesan pertukaran juruaudit yang mempunyai kaitan dengan kos langsung dan tidak langsung semakin bertambah, hampir tiada kajian dijalankan di Malaysia untuk meneliti sebab-sebab berlakunya pertukaran juruaudit atau membuat anggaran terhadap implikasi kesan kekayaan bagi pemegang-pemegang saham. Oleh itu, objektif kajian ini ialah untuk memulakan penyelidikan terhadap suatu aktiviti perakaunan yang sangat penting dalam ekonomi Malaysia yang pesat berkembang. Iaitu kesas pertukaran juruaudit. Kajian ini mungkin juga dapat dicontohi oleh kajian-kajian yang berkaitan di negara-negara membangun yang

lain. Objektif khususnya ialah (a) menentukan faktor-faktor penyebab bagi pertukaran juruaudit di Malaysia, (b) meneliti kaitan secara hypotesis antara perubahan ciri-ciri firma dan pemilihan juruaudit, serta (c) menentukan kesan pertukaran juruaudit terhadap penilaian semula saham di Malaysia. Firma-firma audit di negara ini boleh di kelaskan pada kategori yang berprestij rendah atau berprestij tinggi dan keadaan ini diharapkan boleh membantu penyelidik menentukan kesan penilaian semula itu.

Ramai penyelidik telah meneliti faktor-faktor penentu bagi penukaran juruaudit dan kesannya terhadap penilaian saham. Sebahagian daripada usaha penyelidikan ini telah menghasilkan penemuan-penemuan yang saling tidak konsisten. Maka penyelidikan yang dijalankan kini dibuat dengan tujuan merangkakan suatu teori dan model empirik serta menjelaskan tujuan mengambil kira beberapa faktor tertentu yang penting bagi membuat keputusan di peringkat pengurusan korporat untuk menukar juruaudit, hatta kesannya ke atas penilaian saham. Empat teori perakaunan dan pengauditan yang masih diguna pakai (teori agensi, teori pertukaran juruaudit serta pertukaran juruaudit terpilih, teori isyarat, dan teori jangkaan rasional yang agak ketara) ditinjau dan rangka teori dibentuk daripada keempat-empat teori ini.

Suatu kaedah telah dicipta untuk menguji faktor-faktor yang dipercayai menjadi penentu penukaran juruaudit. Satu sampel 108 firma pelanggan telah dipilih berdasarkan kejadian menukar juruaudit sekurang-kurangnya sekali dalam tempoh di antara 1986 hingga 1996. Selain itu, kajian ini menggunakan kaedah regresi logistik berperingkat untuk menentukan penyebab-penyebab pertukaran juruaudit dan pemilihan juruaudit yang dibeza-bezakan mutunya, yang ada kaitan dengan

perubahan-perubahan pada ciri-ciri firma itu. Kaedah kaji peristiwa telah digunakan untuk meneliti kesan penilaian saham akibat pertukaran juruaudit.

Hasil regresi logistic, *pembolehubah, perubahan dalam pengurusan, pertumbuhan pusing ganti selepas dan sebelum menukar jurududit* dan prestasi firma menjadi penentu-penentu yang utama berlakunya penukaran juruaudit di Malaysia. Walau bagaimanapun, pembolehubah, laporan juruaudit, upah pengauditan dan prestasi firma pelanggan tidak mempunyai kesan yang penting terhadap pertukaran juruaudit di Malaysia. Bagi faktor-faktor yang menerangkan tentang pilihan terhadap firma juruaudit yang dibeza-bezakan mutunya (Tier1 vs Tier2), kajian ini mendapati bagi Tier1, penumbuhan aset, perubahan aliran tunai, keumpilan firma selepas pertukaran juruaudit, dan perolehan aset tetap berbanding aset keseluruhan sesuatu firma pelanggan, merupakan penentu-penentu penting dalam memilih juruaudit di Malaysia. Sementara pemilihan bagi Tier2, faktor-faktor seperti pengurangnya dalam saiz, keumpilan yang rendah dan perolehan aset tetap mempengaruhi pemilihan juruaudit.

Dengan menggunakan kaedah kaji peristiwa yang “standard”, penyelidikan ini mendapati bahawa reaksi pasaran yang positif terhadap penukaran juruaudit di Malaysia adalah lemah. Biarpun begitu, sebaik saja kesan penilaian semula pertukaran juruaudit diuji berdasarkan jenis pertukaran serta ciri ketara firma, penemuan-penemuan yang berlainan telah muncul. Pasaran menunjukkan reaksi positif kepada firma-firma pelanggan yang telah menukar kepada firma audit yang berprestij tinggi. Pulangan terkumpul abnormal (*Cumulative abnormal return – CAR*) sebelum pengumuman dibuat, yang merangkumi tempoh (-60 hari hingga -0 hari) dan (-8 hari hingga -1 hari) telah menunjukkan pulangan laba bersih, masing-

masing sebanyak 7.85% dan 2.24%. (Peratusan yang dianggap memberi kesan ketara ialah 10% atau lebih). Peratusan ini mencerminkan hasil yang memberangsangkan bagi para pelabur. Sebaliknya, kesan penilaian semula terhadap firma-firma yang menukar kepada firma pengauditan yang berprestij rendah menunjukkan pulangan terkumpul abnormal yang negatif. Pulangan terkumpul abnormal (*CAR*) bagi tempoh (-8 hari hingga 1 hari) menunjukkan kerugian terkumpul sebanyak -4.56%. Ini mencerminkan kemerosotan dalam kekayaan pemegang saham. Tambahan pula, kesan penilaian semula dari pertukaran juruaudit dalam kumpulan ini menunjukkan reaksi pasaran negatif yang lemah. Ini pula tidak mempunyai kaitan dengan sebarang perubahan harga semasa yang meliputi pertukaran juruaudit. Analisis lanjut ke atas kesan penilaian semula akibat menukar juruaudit dalam firma-firma yang stabil kedudukan kewangannya dan firma-firma yang kurang stabil kedudukan kewangannya, juga telah dijalankan. Hasil kajian menunjukkan reaksi pasaran positif yang lemah terhadap pertukaran juruaudit di firma-firma yang kukuh, berbanding firma-firma yang kurang stabil kedudukan kewangannya. Firma-firma jenis ini mencetuskan reaksi negatif yang agak ketara. Tambahan pula, firma pelanggan yang menerima undian sangka baik yang banyak sebelum pertukaran juruaudit, telah mendapat reaksi pasaran positif yang lemah apabila pertukaran juruaudit dilakukan. Walaupun terdapat pulangan abnormal yang agak ketara apabila berlakunya pertukaran juruaudit, tiada satupun jenis pertukaran juruaudit menampakkan sebarang pulangan abnormal yang jelas pada hari pengumuman itu dibuat. Ini adalah akibat kebocoran maklumat yang sering berlaku di pasaran-pasaran yang sedang berkembang, seperti di Malaysia.

ACKNOWLEDGEMENT

First and foremost, all praised be Allah (S.W.A) for giving me this wonderful opportunity to pursue this very Ph.D. program without whose blessing I will not be here today with my supervisors and fellow colleagues at UPM.

I wish to express my heartiest gratitude to my thesis supervisor and supervisory committee Dr. Mohamad Ali Abdul Hamid, Assoc.Prof. Dr. Annuar Md.Nasir and Assoc.Prof. Dr. Shammsher Mohamed for their co-ordinated effort, willingness, invaluable ideas, consistent guidance and support in the preparation of this thesis work.

My utmost gratitude goes to Professor Dr. Mohamed Ariff of Monash University (also Bank Bumi-Commerce Chair, Professor of Banking and Finance) for his invaluable ideas, direction on original research, consistent guidance through seminar in finance class and continual reading of my thesis at various stages, which benefited me a lot and ensured the preparation of a satisfactory thesis.

Special thanks go to Assoc. Prof. Dr. Annuar Md. Nassir and Dr. Abu Hassan Omar, for providing graduate assistantship without which I would have a difficult time continuing a lengthy process of Ph.D. research.

I would like to take this opportunity to register my heartiest gratitude to my beloved late father Mr. Aliahmed who consistently urged me to pursue higher education despite facing difficulties and my beloved mother Aiashabanu, for her prayers and encouragement for success.

And I would like to thank to my brothers Dr. Mohamed Yunus, Dr. Zainal Abdin, Mohamed Haroon, Mohamed Tahir, Ali Joher, Sayed Joher, Hassan Joher and Mohammad Sayed for their continual encouragement and prayer. And I would like to extend appreciation to my fellow and friends, Br.Habibur Rahman, Sayedul Amin, and Noor Mohamed from Burma and my fellow colleagues Lee Lee, Ahsanul, Taufiq, Jahan, Salah, Khalid, Naveed, Sharif, Nuraizah, Ihlam, Eid and others at UPM and IIUM for their consistent encouragement and support. But last not the least I would like to extend my appreciation to librarians of UPM, KLSE, and MIA for their ever-willing help. To them all, and my fellow Ph.D. students, I have a great deal for their invaluable help.

I certify that an Examination Committee has met on 17th May, 2000 to conduct the final examination of Huson Joher Aliahmed on his Doctor of Philosophy thesis entitled "Revaluation Effect of Auditor Switch in Malaysia and Its Determinants" in accordance with Universiti Pertanian Malaysia (Higher Degree) Act 1980 and Universiti Pertanian Malaysia (Higher Degree) Regulations 1981. The Committee recommended that the candidate be awarded the relevant degree. Member of the Examination Committee are as follows:

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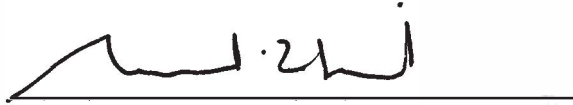


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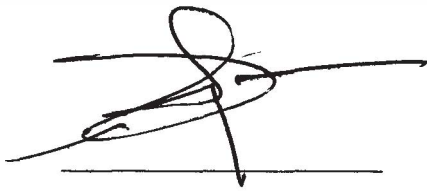
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DECLARATION

I hereby declare that the thesis is based on my original work except for quotations and citations, which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or any other institutions.

Signed

A handwritten signature in black ink, consisting of a large, stylized 'H' followed by a horizontal line and a vertical stroke.

Huson Joher Aliahmed

Date: 9/6/2020

TABLE OF CONTENTS

	Page
DEDICATION	ii
ABSTRACT	iii
ABSTRAK	vii
ACKNOWLEDGEMENTS	xi
APPROVAL SHEETS	xiii
DECLARATION FORM	xv
LIST OF TABLES	xx
LIST OF FIGURES	xxi
LIST OF ABBREVIATIONS	xxii
 CHAPTER	
 I REVALUATION EFFECT OF AUDITOR SWITCH IN MALAYSIA AND IT DETERMINANTS	 1
Research Background	1
Significance of the Study	8
Objectives of the Study	10
Organisation of the Thesis	11
 CHAPTER	
 II AN OVERVIEW OF MALAYSIAN ACCOUNTING AND AUDITING PROFESSION	 12
Introduction	12
Malaysian Financial Reporting Practices	15
MACPA and Malaysian Accounting Profession in Malaysia	16
MIA and Development of Accounting Profession in Malaysia	19
Role of Auditing and Challenge Facing the Profession	20
Continuing Demand for Accounting and Auditing Profession In Malaysia	20
Accounting Standard Pronouncement in Malaysia	22
Approve Auditing Standards in Malaysia	24
International Auditing Guidelines (IAG)	25
Malaysian Auditing Guidelines (MAG)	25
Compliance with Approved Auditing Standard	26
Code of Conduct for Professionalism	26
Auditing Practice Board	28
Financial Statement Review	28
Professional Conduct and Ethics	28
Research and Publications	29
Professional Development	29
MIA and Approved Auditing Standards in Malaysia	29



Auditing Guidelines on Auditors' Responsibility	31
Issue of Corporate Governance and Role of Professional Bodies in Malaysia	31
Guidelines of the Securities Commission, 1995	35

CHAPTER

III	THEORETICAL FRAMEWORK :	
	AGENCY PROBLEMS AND AUDITOR CHOICE	36
	Introduction	36
	Agency Theory	37
	Agency Cost and Demand for Quality Differentiated Audits	40
	Demand for Audit Assurance	40
	Nature of Owner-Manager Conflict	41
	Agency cost of Equity	42
	Simple Analysis of Sources of the Agency Cost of Equity and Firms Value	44
	Agency cost of Debt and Demand for Quality Differentiated Audit Firms	49
	Incentive Effect Associated with Debt Financing	50
	Capital Structure and Agency Cost	55
	Theory of Auditor Choice	58
	Theory of Auditor Change	59
	Changes in Client Contracting Environment	59
	Auditor Effectiveness	59
	Client Reputation (Condition of the Firm)	61
	Signalling Theory	62
	Partially Revealing Rational Expectation Theory	65
	Market Response to Auditor Switch : A Theoretical Approach	73
	Summary of Theories	79

CHAPTER

IV	REVIEW OF LITERATURE	80
	Introduction	80
	Determinant of Auditor Switch	81
	Changes in Firms Activities and Choice of Auditors	90
	Market Reaction to Auditor Switch	95
	Financial Condition and Changes in Perceived Audit Quality	100
	Summary of the Literature	102

CHAPTER

V	DATA AND METHODOLOGY	103
	Introduction	103
	Research design	103
	Sample Selection Process	103
	Data and Variables	105
	Model Development	106
	Derivation of Logistic Regression Method	107
	Test Model	114
	Simple Parametric Test Model	114
	Auditor Change Model	115
	Auditor Choice Model	119
	Event Study Methodology	124
	Return Measurement	125
	Correction For Non-Synchronous Trading	127
	Abnormal (Residual) and Cumulative Returns Measures	129
	Hypothesis Generation	131
	Strategic Hypotheses	131
	Subsidiary Hypotheses	133
	Statistical Design	135
	Statistical Inference for Logistics Regression Model	135
	Test Statistics for Abnormal Return Analysis	138

CHAPTER

VI	FINDINGS I: DETERMINANTS OF AUDITOR SWITCH IN MALAYSIA	140
	Introduction	140
	Regression Result on the Determinant of Auditor Switch	142
	Regression Result on Changes in Firms Characteristics	
	Choice of Quality Differentiated Auditors	148
	Reliability Test	154
	Summary	155

CHAPTER

VII	FINDINGS II : REVALUATION EFFECT OF AUDITOR SWITCH	157
	Introduction	157
	Revaluation Effect of Auditor Switch (Overall Sample)	158
	Revaluation Effect of Auditor Switch to Higher Prestige (Tier1) Audit Firms	161
	Revaluation Effect of Auditor Switch to Less Prestige (Tier2) Audit Firms	164
	Revaluation Effect of Auditor Switch Type (Within Classes)	165

	Revaluation Effect of Auditor Switch by Both healthy and Unhealthy Firms	169
	Pre-Switch Audit Opinion and Revaluation Effect	171
	Result Discussion	173
CHAPTER		
VIII	CONCLUSION, LIMITATIONS AND RECOMMENDATION	177
	Limitations and Further Research	182
	Policy Implications	183
	BIBLIOGRAPHY	185
	APPENDICES	197
	VITA	221

LIST OF TABLES

1. Simple Parametric Test for Mean Difference of Firms Characteristics Between Switch and Non-Switched Group
2. Logistic Regression Result for Determinant of Auditor Switch
3. Simple Parametric Simple Test For The Mean Difference of Firms Characteristics Between Clients Firms That Switch to Tier1 and Tier2 Audit Firms
4. Logistic Regression Result for Choice of Tier1 Audit Firms
5. Logistic Regression Result for Choice of Tier2 Audit Firms
6. Correlation Coefficient Matrix (Choice of Tier1 Model)

LIST OF FIGURES

1. Role Of Monitoring And Bonding Activities In Reducing Agency Cost
2. Optimal Capital Structure and Agency Cost
3. Changing Investors Expectation
4. CAR Analysis for Auditor Switch (Overall Samples)
5. CAR Analysis for Auditor Switch (Tier2 to Tier1)
6. CAR Analysis Auditor Switch (Tier1 to Tier2)
7. CAR Analysis for Auditor Switch (Tier1 to Tier1)
8. CAR Analysis for Auditor Switch (Teir2 to Tier2)
9. CAR Analysis for Auditor Switch (Financially Healthy Firms)
10. CAR Analysis for Auditor Switch by Financially Unhealthy Firms
11. CAR Analysis For Auditor Switch by Firms with Pre-Switch Clean Opinion

LIST OF ABBREVIATIONS

AICPA= AMERICAN INSTITUTE OF CHARTERED PUBLIC ACCOUNTANT

AR = AVERAGE ABNORMAL RETURN

ASR = ACCOUNTING SERIES RELEASE

CAR = CUMULATIVE ABNORMAL RETURN

CPA = CHARTERED PUBLIC ACCOUNTANTS

CPD = CONTINUED PROFESSIONAL DEVELOPMENT

GAAP =GENERALLY ACCEPTED ACCOUNTING PRACTICE

IAG = INTERNATIONAL AUDITING GUIDELINE

IASC = INTERNATIONAL ACCOUNTING STANDARD COMMITTEE

ICAEW= INSTITUTE OF CHARTERED ACCOUNTANTS OF ENGLAND
AND WALES

IFAC = INTERNATIONAL FEDERATION ACCOUNTANTS

IPOs = INITIAL PUBLIC OFFERING

ISA = INTERNATIONAL STANDARD ON ACCOUNTING

ISB = INDEPENDENT STANDARD BOARD

MACPA= MALAYSIAN ASSOCIATION OF CHARTERED PUBLIC
ACCOUNTANT

MAS = MALAYSIAN AUDITING STANDARDS

MASB= MALAYSIAN AUDITING STANDARD BOARD

MDA = MULTIVARIATE DISCRIMINANT ANALYSIS

MRS = MARGINAL RATE OF SUBSTITUTION

OLS = ORDINARY LEAST SQUARE